IN THE

Supreme Court of the United States

OCTOBER TERM, 1927.

NATIONAL LIFE INSURANCE COMPANY,
Petitioner,

against

UNITED STATES OF AMERICA,
Respondent.

No. 228

BRIEF FOR *AMICI CURIAE.*

This brief is filed on behalf of the Metropolitan Life Insurance Company, the Mutual Benefit Life Insurance Company, and the Prudential Insurance Company, as *amici curiae*, in support of the Government's position in this case.

The method of taxing life insurance companies which is here brought into question, was carefully arranged after consultation with the representatives of leading insurance companies in order to provide a reasonable and fair basis of taxation and to avoid the difficulties which had grown out of the application of earlier statutes. This method is believed by the insurance companies, on whose behalf this brief is submitted, to be a fair one, and this belief, it is thought, is generally shared. It is for this reason that we support the contention of the Government in this case.

The tax under Sections 242-245 of the Revenue Act of 1921 relating to life insurance companies is a special excise tax which is specially designed to meet the situation of companies of this class. The tax is not laid on all of the income of life insurance companies. These companies have large incomes in addition to those received "from interest, dividends and rents" to which Section 244 applies. These incomes are derived from the premiums paid by policyholders. From these premiums large expenses of the administration of the insurance business, and losses and other amounts payable on policies, are annually met. It will be observed that the plan of taxation in question contains no provision for the deduction of such expenses, losses and payments, aside from the expenses which may be regarded as applicable to the investments from which the "interest, dividends and rents" are derived.

Under the several Income Tax Acts and Revenue Acts prior to the Revenue Act of 1921 insurance companies were compelled to return their total income and were allowed deductions for all their expenses and certain net additions to reserve. But this method did not deal fairly with the peculiar business of life insurance companies. A life insurance company is required by State laws as a condition of continuing business to maintain its assets at a sum not less than the amount of what is called the "legal reserve" required by such laws. The amount of legal reserve is calculated annually by the supervising commissions and by the companies and is based upon an assumed rate of mortality formulated from long experience and an assumed rate of income from invested funds conservatively estimated at usually 3½ or 4%. In the case of mutual life insurance companies the amounts which go to make up the reserve

are contributed by the members, who are the policyholders, through payments of premiums and are also derived from the increases resulting from investments. These assets constituting a reserve do not represent indebtedness any more than the capital of a stock corporation subscribed by its stockholders represents indebtedness. This question was recently considered by the Supreme Court of the United States in the case of *Duffy* v. *Mutual Benefit Life Insurance Company*, 272 U. S. 613, from which we have taken the substance of the above statement. In that case it was held that the reserve constituted "invested capital" within the meaning of the sections of the Revenue Act of 1917, relating to the excess profits tax.

It is apparent that in a strict income tax act there would be considerable amounts which would have to be reported as income which are not to be reported by life insurance companies under the Revenue Act of 1921, and that under this later act a deduction was allowed, that of a certain percentage of the mean of the reserve funds required by law and held during the taxable year, which would not necessarily be allowed as a deduction in the case of an ordinary income tax.

We make these observations at the outset because it seems to us that the entire method of taxation is misconceived by the claimant in this case and that its argument proceeds upon an essentially erroneous basis.

The difficulties that were encountered in the administration of the earlier income tax acts in relation to life insurance companies are illustrated by such cases as *McCoach* v. *Insurance Company of North America*, 244 U. S.

585; *Maryland Casualty Company* v. *United States*, 251 U. S. 342; *United States* v. *Boston Insurance Company*, 269 U. S. 197; and *New York Life Insurance Company* v. *Edwards*, 271 U. S. 109.

In view of these difficulties it was proposed when the Revenue Act of 1918 was framed to provide a new plan for the taxation of life insurance companies which was thus described by Senator Simmons:

> "The tax is in form an income tax, but is imposed upon a net income defined with special reference to the peculiar conditions of the business of life insurance. Roughly, it consists of the gross income from interest, dividends, and rents, less tax-free interest, investment expenses, and taxes and other expenses paid exclusively in connection with the real estate owned by the company." (Sen. Rep. No. 617, 65th Cong. 3d Sess., H. R. 12863.)

The House of Representatives refused to accept the proposed plan at that time.

The change, however, which was complete and fundamental, was made in the Revenue Act of 1921. Concerning these changes the House Committee said:

> "The provisions of the present law applicable to life insurance companies are imperfect and productive of constant litigation. Moreover, the taxes paid by life insurance companies under the income tax law are inadequate. It is accordingly proposed in lieu of all other taxes to tax life insurance companies on the basis of their investment income from interest, dividends, and rents, with suitable deductions for expenses fairly chargeable against such investment income." (House Rep. No. 350, 67th Cong. 1st Sess., H. R. 8245.)

The Taxing Statute.

The following are all of the material provisions of the Taxing Statute:

TITLE II, PART III, TAXES ON INSURANCE COMPANIES (42 STAT. 261.)

SEC. 243. That in lieu of the taxes imposed by sections 230 and 1000 and by Title III, there shall be levied, collected, and paid for the calendar year 1921 and for each taxable year thereafter upon the net income of every life insurance company a tax as follows:

(1) In the case of a domestic life insurance company, the same percentage of its net income as is imposed upon other corporations by section 230;

* * * * * *

SEC. 244. (a) That in the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

* * * * * *

SEC. 245. (a) That in the case of a life insurance company the term "net income" means the gross income less—

(1) The amount of interest received during the taxable year which under paragraph (4) of subdivision (b) of section 213 is exempt from taxation under this title;

(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and

end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

(3) The amount received as dividends (A) from a domestic corporation other than a corporation entitled to the benefits of section 262, or (B) from any foreign corporation when it is shown to the satisfaction of the Commissioner that more than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the foreign corporation has been in existence) was derived from sources within the United States as determined under section 217;

(4) An amount equal to 2 per centum of any sums held at the end of the taxable year as a reserve for dividends (other than dividends payable during the year following the taxable year) the payment of which is deferred for a period of not less than five years from the date of the policy contract;

(5) Investment expenses paid during the taxable year: *Provided*, That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year;

(6) Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. The deduction allowed by this paragraph shall be allowed in the case of taxes imposed upon a shareholder or member of a company upon his interest as shareholder or member, which are paid by the company without reimbursement from the shareholder or member, but in such cases no deduction shall be allowed the shareholder or member for the amount of such taxes;

(7) A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence. In the case of property acquired before March 1, 1913, this deduction shall be computed upon the basis of its fair market price or value as of March 1, 1913;

(8) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation upon this title;

(9) In the case of a domestic life insurance company, the net income of which (computed without the benefit of this paragraph) is $25,000 or less, the sum of $2,000; but if the net income is more than $25,000 the tax imposed by section 243 shall not ex-

ceed the tax which would be payable if the $2,000 credit were allowed, plus the amount of the net income in excess of $25,000.

(b) No deduction shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied.

(c) In the case of a foreign life insurance company the amount of its net income for any taxable year from sources within the United States shall be the same proportion of its net income for the taxable year from sources within and without the United States, which the reserve funds required by law and held by it at the end of the taxable year upon business transacted within the United States is of the reserve fund held by it at the end of the taxable year upon all business transacted.

Subdivision (b) of Section 213 of the Act enumerates various classes of income which are exempt from taxation. Paragraph (4) of this subdivision (42 Stat. 238) to which reference is made in Section 345 (a) (1) *supra*, is as follows:

(4) Interest upon (a) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (b) securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916; or (c) the obligations of the United States or its possessions; or (d) bonds issued by the War Finance Corporation. In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit), and in the case of bonds issued by the War Finance Corporation, the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt to the taxpayer from income, war-profits and excess-profits taxes.

Summary of Argument.

First. The return which was required from the petitioner was in exact accord with the statute.

Second. No tax has been laid on the income from State or municipal securities or on the income from obligations of the United States. The petitioner has been allowed complete exemption from taxation on such income.

Third. The amount of the tax exempt interest is not used as the basis or as the measure of the tax.

Fourth. The Statute cannot be attacked upon the ground that the tax is discriminatory.

Fifth. Congress was entitled to provide a special excise tax for life insurance companies and to fix the measure of the tax as provided in Sections 244 and 245.

ARGUMENT.

FIRST. The return which was required from the petitioner was in exact accord with the statute.

The return which the petitioner was required by the Collector of Internal Revenue for the District of Vermont to file was as follows (R. 14):

Gross Income.

Items.			
1.	Interest from all sources (including tax exempts)		$3,811,132.78
2.	Dividends on stock of domestic and foreign corporations		.....
3.	Rents		13,460.00
4.	Total items 1 to 3		$3,824,592.78
	Deductions.		
5.	Interest exempt from taxation	$1,125,788.26	
6.	Excess of 4% of the mean of the reserve funds over item 5	1,569,490.86	
8 to 13.	Miscellaneous deductions	204,411.67	
14.	Total of items 5 to 13		2,899,690.79
15.	Net income		$924,901.99
	Total tax		92,490.20

There can be no question but that this return is in exact accord with the provisions of the taxing statute. Indeed, no contrary claim is made. There is no question as to the application of the statute, nor but that the proceedings of the Government were in accordance with its terms. The only objections are to its validity, that is, as to the power of Congress to enact it.

SECOND. No tax has been laid on the income from State or municipal securities or on the income from obligations of the United States. The petitioner has been allowed complete exemption from taxation on such income.

No legal or mathematical ingenuity can possibly make out of this case an imposition of a tax upon municipal, State or Federal bonds. The interest derived by the petitioner from the obligations of municipalities and states amounted to $873,075.66 and the interest upon obligations of the United States amounted to $252,712.60 (R. 9). The total of these two amounts is $1,125,788.26. An examination of the return filed by the petitioner in accordance with the requirements of the Government shows that the petitioner was permitted to deduct the sum of $1,125,788.26 from its gross income (R. 9). It is apparent from the face of the return that the item of net income upon which the tax was imposed contains none of the $1,125,788.26 of tax exempt income.

Granted, as petitioner contends, that Congress could not require that in computing income as a basis of taxation, such interest be included in the gross income without providing for an equal deduction, such a deduction has been permitted.

It is true that the petitioner argues that it ought not to be compelled to include the exempt interest in its return of "gross income". But constitutional questions do not turn on forms of words. The tax exempt interest which is included in the "gross income" required to be returned is, by the Statute, the subject of deduction and is not included in the "net income" on which the tax is laid. Thus, the tax exempt interest is not taxed.

The petitioner refers to what was said in the cases of *Evans* v. *Gore*, 253 U. S. 245 and *Miles* v. *Graham*, 268 U. S. 501, with regard to the tax on a judicial salary. But there the point was that not only were the judges to return their compensation as "gross income" but they were taxed upon this amount as upon other salaries or income received. That is, there was no deduction of the amount of the salary. Surely it would not be contended that had the salary been included in the gross income and then had provision been made for its deduction there would have been any cause for complaint on the theory that the salary which was deducted was taxed.

An examination of the forms of return provided by the Government for various classes of income taxpayers reveals that the taxpayer is required to report the amount of his tax exempt income. That requirement is purely an administrative one. So long as the amount of such exempt income is not included in the taxable income, so long as there is effective provision for its deduction before the residue upon which the tax is levied is determined, the statute is not invalid because the taxpayer is required to report such income. In fact, petitioner expressly concedes that it had $2,698,804.52 of gross income which was constitutionally subject to taxation (Petitioner's brief, p. 5). The tax is levied upon only $924,901.99. This, we submit, disposes of the entire issue.

The petitioner has been allowed to deduct from its income from investments the whole amount of the income which is constitutionally exempt. Its whole grievance is that it has not been allowed another deduction in calculating the amount to be deducted as income from reserve. It had

no constitutional right to such a deduction. For that matter it had no constitutional right to any deduction for income from reserve.

The petitioner cannot complain of paragraph (1) of Section 245 (a) for that allows the deduction of all its income from the securities for which it was entitled to exemption. The petitioner's complaint is solely of paragraph (2) of Section 245 (a). But it has no basis for that complaint, for that is a complaint, not of a *subject* of taxation, but of *deduction*. If there had been no paragraph (2), and petitioner had been taxed on the entire income described in paragraph (1) without any deduction for income from reserve, it would have had no ground for objection under the constitution.

Counsel for petitioner attempts to make much of a statement of Professor Adams. But his statement does not detract from the power of Congress or in any way alter the fact that Congress *did* provide for the deduction of income from securities constitutionally exempt and was not bound to give any further deduction.

Disregarding, as we conceive it, the repeated decisions of this Court as to the power of Congress to impose an excise tax, the petitioner, however, has entered the realm of speculative mathematics and by resort to what it calls algebraic expressions, has attempted to demonstrate that the tax in question, stated in algebraic form amounts to:

Net income = Gross Income — 4% of Reserve.

The petitioner then makes this remarkable statement (brief, p. 3):

> "The result is that *all* tax-*exempt* income, being first included in the 'Gross Income' is finally *included*

> *in the taxable net income;* so that the *entire tax* collected from the National Life for 1921 ($92,495.29) was *solely* on account of $924,901.99 income from tax-free State, Municipal and Liberty Bonds."

This paragraph illustrates the fallacy of the petitioner's legal and mathematical argument. There is no warrant for identifying the $924,901.99 of net income with the $1,125,788.26 of tax exempt income. On the contrary the petitioner admittedly had $2,698,804.52 as income which Congress had the constitutional power to tax (Petitioner's brief, p. 5). And, if the tax has been lawfully assessed, the fact that an unlawful tax in the same amount could not be assessed is irrelevant. Moreover, an examination of petitioner's formulae confirms what the income tax return demonstrates,—that the tax exempt income was in fact deducted. There is no basis for the statement that the result of the statute is "that all tax exempt income being first included in the gross income is finally included in the taxable net income". An examination of the return, of the petitioner's formulae, shows that tax exempt interest is the very first thing which is deducted from gross income.

THIRD. The amount of the tax exempt interest is not used as the basis or as the measure of the tax.

The essence of the taxpayer's contention is that since Congress granted all life insurance companies a permitted deduction of four per centum of their reserve, it cannot require the petitioner to apply his tax exempt income against or in satisfaction of the permitted deduction. The fallacy of the argument is in the unwarranted assumption that Congress has allowed such a deduction or was bound by the Constitution to allow it.

Congress did not grant to all life insurance companies an exemption or immunity for an amount equal to four per centum of the income upon their reserves. The only exemptions or deductions which Congress has permitted are those specified in Section 245 of the Act and none other can be spelled out.

The cases of *United States* v. *Ritchie*, Fed. Cas. No. 16,168; *People* v. *Commissioner of Taxes*, 41 How. Pr. 459; *People* v. *Weaver*, 100 U. S. 539; *Farmers Bank* v. *Minnesota*, 232 U. S. 516; *Evans* v. *Gore*, 253 U. S. 245; and *Miles* v. *Graham*, 268 U. S. 501, are not in point.

In *United States* v. *Ritchie*, Fed. Cases 16,168, the administrative officials of the Government without statutory sanction attempted to allocate $1,000 of the taxpayer's salary as State's attorney in Illinois against a general exemption of $1,000 granted all taxpayers. Congress had allowed an exemption which the Federal officials tried to defeat by setting off the salary of the State officer against the exemption to which an act of Congress entitled him. This administrative action the Circuit Court held improper.

People ex rel. Babbitt v. *Commissioner of Taxes*, 41 How. Pr. 459 involved a property tax. The New York Taxing Statute in question imposed a tax upon personal property within the State, permitting a deduction of the taxpayer's liabilities from his assets for the purpose of determining his taxable wealth. The relator had liabilities in excess of his taxable assets. He also owned United States bonds to the value of $250,000. The State Comptroller instructed the Commissioners of Taxes to deduct the amount of the United States bonds from the indebtedness of the taxpayer (*id.* pp. 465, 467) and thus established a remainder for taxation, whereas if the amount of the United States bonds had been deducted from his assets, there would have been nothing left to tax.

People v. *Weaver*, 100 U. S. 539, involved the validity of a state property tax upon shares in a national banking association. The statute of the State of New York permitted taxpayers to deduct from their assets their liabilities and stock in taxed corporations. Since national banks were not taxed on their stock, the state taxing authorities refused to permit stock in national banks to be included in the deduction of the taxpayer. This the Supreme Court held invalid because:

> "It cannot be disputed,—it is not disputed here,—nor is it denied in the opinion of the State court, that the effect of the State law is to permit a citizen of New York, who has money capital invested otherwise than in banks, to deduct from that capital the sum of all of his debts, leaving the remainder alone subject to taxation, while he whose money is invested in shares of bank stocks can make no such deduction."

The states have no power to tax stock in national banks as a right. Congress has extended to the states that power, provided that moneyed capital coming into competition with national banks should be taxed exactly as shares in national banks. This statute violated that rule of equality and hence was invalid.

There is no such requirements imposed upon Congress.

Farmers Bank v. *Minnesota,* 232 U. S. 516, involved a property tax on the surplus of a savings bank. The surplus was ascertained by including all of the company's assets, other than real estate, and deducting therefrom the amount of deposits and all other accounts payable. The taxpayer had $700,000 of bonds issued by municipalities in Indian territory and in the territory of Oklahoma which were thus subjected to a propery tax. This the court held unconstitutional.

In *Evans* v. *Gore,* 253 U. S. 245, and in *Miles* v. *Graham,* 268 U. S. 501, the Supreme Court held that the Federal Constitution prohibited Congress from imposing an income tax upon the salary of federal judges.

None of these cases involves a scheme of taxation similar to that imposed upon life insurance companies, and in none of these cases is such a scheme condemned.

In the present case there was nothing, so far as the Constitution is concerned, to prevent the Congress from imposing a tax upon all of the petitioner's income from rents, dividends and interest except the interest from tax exempt securities that is, on the admitted amount of such income $2,698,804.52. If it had done that the tax which the petitioner constitutionally could have been compelled to pay would have been greatly enhanced. It was taxed only on $924,-901.99. Congress, in the policy of not taxing all that it

could tax, desiring that the funds accumulated by the insurance companies and held for the protection of policy holders should not be jeopardized, permitted, in addition to the exemption of tax exempt income, a sum equal to the excess of four per centum of the mean of the reserve funds over and above the amount of such tax exempt income. The amount of the income of a life insurance company will vary with the character of the investments of the insurance companies. It will vary in accordance with the amount of assets in addition to the reserve held by the Company. But every life insurance company is given an exemption, in addition to the conceded exemption of income from governmental obligations, of an amount equal to four per centum of the mean of the funds which the Company holds, in accordance with legal requirements for the protection of its policy holders in excess of such tax exempt income. The petitioner has neither constitutional nor statutory right to deduct from its income an amount equal to four per centum of the mean of its reserve or to deduct any percentage of its reserve funds or to deduct any interest derived from the investment of its reserve funds. Whatever sums are derived from the investment of the reserve is income, not outlay, not expenses. Congress, as already stated, to meet the peculiar situation of life insurance companies, considered only a part of their income, that from interest, dividends and rents, as gross income, and then permits the deductions which appear in the later provisions of Section 245 for investment expenses and other outlays pertinent to interest, dividends and rents. The deduction of tax exempt securities then permitted is in deference to the established rule in that respect. The additional deduction up to four per centum of the mean of the reserve fund is simply a carving out of a certain part of the interest received on the

assets held in reserve in pursuance of a policy entirely in the discretion of Congress.

There is, to repeat, no question of constitutional right. This was a mere question of policy which Congress was free to adopt as it chose. Congress was under no constitutional mandate to allow the tax exempt interest already deducted under paragraph one to be again deducted from the income on the reserve under paragraph two. Every life insurance company that has tax exempt securities is treated exactly on the same basis. Companies that have tax exempt securities are not entitled to a double deduction and those that have no tax exempt securities still have reserves which they hold for the protection of their policy holders and Congress has fairly allowed a deduction of a percentage of those reserves.

The three cases relied upon by the petitioner as "directly in point" in nowise involve, affect, or even discuss the power of Congress to impose the tax here in question.

The case of *Miller* v. *Milwaukee*, 272 U. S. 713, lends no support to the contention of the petitioner. It was stipulated in that case that the dividends, which it was held could not be taxed by the State of Wisconsin, were directly declared from interest accruing from United States Bonds (id. p. 716). The scheme of the State statute, as it operated taxed these dividends and freed dividends from other sources.

Packard Motor Car Company v. *City of Detroit*, 232 Mich. 245, was also a case of a property tax. There the statute of Michigan provided (p. 246):

> "For the purpose of taxation personal property shall include: * * * All credits of every kind belonging to inhabitants of this State, whether such

> indebtedness is due from individuals or from corporations, public or private, and whether such debtors reside within or without the State, except such as are expressly exempted from taxation by law. * * *
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> "The following personal property shall be exempt from taxation, to wit: * * * So much of the debts due or to become due as shall equal the amount of *bona fide* and unconditional debts by the person owing: *Provided, That if such person shall be the owner of credits that are exempt from taxation such proportion only of his indebtedness shall be deducted from debts due or to become due as is represented by the ratio between taxable credits and total credits owned, whether taxable or not.*"

At the time of the imposition of the tax in question, the Company had *bona fide* debts far in excess of its credits other than its tax exempt securities. So that the Company had no property properly taxable. The taxing authorities attempted to reduce the amount of the deductible debts in proportion to the Company's ratio of taxable credits to total credits. The Michigan court held that the tax was a property tax and that the italicized portion of the statute above quoted was unconstitutional.

Nor is *City of Waco* v. *Amicable Life Insurance Company*, 230 S. W. 698 (Tex. Civ. App.), in point. That was the case of a property tax. The question was as to the propriety of a property tax imposed by the City of Waco upon the personal property of the taxpayer within the city. It appeared that the total value of its personal assets on January 1st was $2,287,780.26 and that the reserve of the company amounted to $1,631,754.06. The City of Waco assessed the company's personal property for taxation purposes at the value of $557,600. In arriving at this value,

the amount of the reserve was deducted from the value of its personal assets. The company, however, owned certificates of indebtedness and United States bonds of the value of $906,650. The Court held that the United States obligations should have been deducted from the amount of the personal property of the taxpayer, and then the amount of the reserve should be deducted from the residue. The statute in question read as follows:

> "From the total valuation of its assets shall be deducted the reserve, being the amount of the debts of the insurance companies by reason of their outstanding policies in gross, and from the remainder shall be deducted the assessed value of all real estate owned by the company and the remainder shall be the assessed taxable value of its personal property."

The statute thus, in laying the tax on property, specifically authorized the deduction of the total amount of the reserve, the legislature having enacted that the reserve constituted a debt. The result was that the tax was actually laid on property constitutionally exempt. The Court said (p. 702):

> "The legislature had expressly authorized the deduction of the entire amount of the reserve without condition. This allowance has not been made to depend upon how the reserve is invested, or whether the assets it apparently represents be exempt or non exempt. * * * The deduction of the reserve authorized by the statute appears to be allowed without regard to how it is invested, or what character of property it represents, and is allowed evidently on the theory that its amount is not an asset but is a liability."

The case was affirmed in 248 S. W. 332. The opinion of the Commission of Appeals was concerned with the fact that under the Texas statute the reserve is not an asset but a liability. Moreover, the Court pointed out that the taxing statute expressly provided that personal property of the insurance company should be valued as other property was valued for assessment in the state and demonstrated by reference to such other statutes that the taxpayer was not required to report the amount of such United States bonds.

In this case, the petitioner is not taxed upon income from governmental bonds directly or indirectly. The amount of his tax is not determined by the amount of his income from such tax exempt securities.

Petitioner's counsel, with an excess of ingenuity, endeavors to maintain that a recognition of the authority of Congress to lay the tax in question would open the way to the States to achieve unconstitutional levies upon subjects of taxation beyond their jurisdiction. We shall not attempt to follow counsel in his attempts at mathematical demonstrations. For, as it appears to us, all his illustrations involve the same fallacy.

The States cannot tax what is not within their jurisdiction, whether it be real estate or tangible personal property having its situs outside, or the securities or agencies of the Federal Government. It may safely be assumed that no such efforts at unconstitutional taxation will be permitted to succeed.

Congress cannot tax the agencies of the State governments or securities issued by the States or their political subdivisions. But all this discussion, and all these illustrations, bring us back to the point—as to the tax here

in question. And no algebraic illustrations can make it other than what it is.

Congress has not taxed the income from State securities. It has expressly exempted them. *The whole quarrel of petitioner is with paragraph (2) of Section 245 (a) and this relates entirely to a further deduction which Congress was not bound to allow at all, and which it could allow without permitting a second deduction of the tax exempt interest already deductible under paragraph (1).*

Suppose an insurance Company has constitutionally exempt securities. Is it not entitled under this statute to deduct the entire income from them? Has it any constitutional right to insist on again deducting this income as a part of its income from its reserve?

Suppose an insurance Company has no constitutionally exempt securities. Then, of course, it is not entitled to any deduction on that score.

The whole point of the petitioner, after all its incursions into mathematics, is not that it is taxed on its income from State securities, but that it is not permitted to include these securities in figuring its deduction for reserve. What ground is there in that for constitutional objections?

FOURTH. The Statute cannot be attacked upon the ground that the tax is discriminatory.

It is contended that the statutory plan of taxing life insurance companies is invalid on the ground of discrimination. It is said that there is discrimination against the owner of tax exempt securities.

We submit that the contention is unsound.

How is the owner of tax-exempt securities discriminated against? The insurance company that wishes to invest in them is not denied its full opportunity. It is not taxed upon them or upon the income from them. If the investment is an advantageous one, the company secures all the advantages without any diminution whatever.

The point of petitioner's counsel is that the company is not allowed to figure its tax-exempt income in obtaining a second deduction on its reserve. But this does not detract from its ownership of tax-exempt securities unimpaired and untaxed. The petitioner has no constitutional right to gain an advantage from its investment in tax-exempt securities beyond the fact that it is not to be deprived in whole or in part of its investment and that the investment is not to be made a subject of taxation. The answer to petitioner's argument on this score is that in no respect does the petitioner suffer under this act of Congress by reason of its investment in tax-exempt securities. It is put in no worse position. What the petitioner wants, is not simply to have its constitutional right protected, and to be immune from taxation on its investment in governmental securities, but to get a further advantage, to which it has no constitutional right, that is, to include is tax-exempt income in

figuring its deduction on its reserve. It seeks not freedom from taxation but a preferred position in calculating its reserve. What is there in the constitution which compels Congress to give such an advantage?

It is said that companies, having tax-exempt securities, and those not having them, may in the end pay the same tax on the same amount of income. But this would prove nothing, so far as constitutional validity is concerned. If the company, having tax-exempt securities, should pay ultimately the same amount, it would not be because the income from the tax-exempt securities was taxed, but solely because it received no preference by being allowed a second deduction in the amount allowed to be deducted for reserve. The company may or may not come out in the same way in the end. Its other investments may not afford the same security and may not give the same assured income as its State bonds. Whatever advantage the company has in that class of securities, it obtains without being compelled to submit to any tax upon them. And if the company by obtaining a higher rate of return on other classes of investments is the gainer, it is still allowed a deduction of only a fixed percentage of the mean of its reserve so invested. This allowance of a deduction of a fixed percentage, or 4 per cent. of the mean of the reserve, itself points the nature of the deduction, not as a right but as a favor. In granting this favor, in the interest of policyholders, Congress was entitled to consider the deduction already allowed for income on tax-exempt securities. How particular companies will come out in the end, so long as constitutionally exempt securities are not taxed, is beside the mark.

Congress may not tax State bonds, but it is not bound to hold out special inducements to invest in tax-exempt securities.

The point of alleged discrimination between life insurance companies has further answer in the fact that it has again and again been pointed out by the Supreme Court that in the power of taxation Congress is not fettered by any provision as to uniformity, save as to geographical uniformity.

The provision with respect to the taxing power is found in Art. I, Sec. 8, Clause I, as follows:

> "The Congress shall have Power. 1. To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States."

Uniformity "throughout the United States" means geographical uniformity.

This question was considered in *Knowlton* v. *Moore*, 178 U. S. 41, in an elaborate opinion of the Court delivered by Mr. Justice White. There he said, in answer to the attack upon the War Revenue Act of Congress (Act of June 13, 1898, c. 448, 30 Stat. 448) imposing a tax on legacies and distributive shares of personal property (p. 98):

> "Thus it is apparent that the expression 'uniform throughout the United States' was at that time" [referring to the origin of the clause] "considered as purely geographical, as being synonymous with the expression 'general operation throughout the United States,' and that no thought of restricting Congress to intrinsic uniformity obtained, since the powers recommended were absolutely in conflict with such theory."

After reviewing the history of the clause in the Federal Convention, he concluded (p. 106):

> "By the result then of an analysis of the history of the adoption of the Constitution it becomes plain that the words 'uniform throughout the United States' do not signify an intrinsic but simply a geographical uniformity."

In *Patton* v. *Brady*, 184 U. S. 608, the Court said (p. 622):

> "Counsel speaks of the power to impose an excise as an arbitrary, unrestrained power, but the Constitution, art. 1, sec. 8, provides that 'all duties, imposts, and excises shall be uniform throughout the United States.' The exercise of the power is, therefore, limited by the rule of uniformity. The framers of the Constitution, the people who adopted it, thought that limitation sufficient, *and courts may not add thereto.* That uniformity has been adjudged to be a *geographical uniformity*" (Italics ours).

In *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, dealing with the Corporation Tax Act of 1909, one objection to the tax was that it was "so unequal and arbitrary in the fact that it taxes a business when carried on by a corporation and exempts a similar business when carried on by a partnership or private individual as to place it beyond the authority conferred upon Congress." But the Court held the contention to be wholly untenable, saying (p. 158):

> "As we have seen, the only limitation upon the authority conferred is uniformity in laying the tax, and uniformity does not require the equal application of the tax to all persons or corporations who may come within its operation, but is limited to

> geographical uniformity throughout the United States. This subject was fully discussed and set at rest in *Knowlton* v. *Moore*, 178 U. S. 41, *supra*, and we can add nothing to the discussion contained in that case."

See also *Billings* v. *United States*, 232 U. S. 261, 282.

The same question was raised when the income tax provisions of the Act of October 9, 1913, were challenged in the leading case of *Brushaber* v. *Union Pacific Railroad Co.*, 240 U. S. 1. One of the principal grounds for attack in that series of cases was the number of discriminations found in the income tax provisions. The Court dismissed these because of their obvious lack of legal merit, repeating what had already been said in the decisions we have cited. The Court said (p. 24):

> "So far as these numerous and minute, not to say in many respects hypercritical, contentions are based upon an assumed violation of the uniformity clause, their want of legal merit is at once apparent, since it is settled that that clause exacts only a geographical uniformity and there is not a semblance of ground in any of the propositions for assuming that a violation of such uniformity is complained of."

In the recent case of *Barclay & Co.* v. *Edwards*, 267 U. S. 442, the Court, by Chief Justice Taft, addressed itself again to this subject. In that case it was complained that the taxation by Congress of the income of a domestic corporation derived from sale abroad of goods bought or made by them in this country violated due process of law because a like tax was not imposed upon the income similarly derived by foreign corporations. The Court dismissed the

contention (p. 450) by repeating what had been said in *Evans* v. *Gore*, 253 U. S. 245, 256, as to the taxing power of Congress:

> "It may be applied to every object within its range 'in such measure as Congress may determine'; enables that body 'to select one calling and omit another, to tax one class of property and to forbear to tax another'; and may be applied in different ways to different objects so long as there is 'geographical uniformity' in the duties, imposts and excises imposed."

There is not the slightest doubt of the power of Congress to discriminate between life insurance companies and other taxpayers. The Congress may have a special method of taxation for life insurance companies if it sees fit, so long as the taxation is geographically uniform throughout the United States. Likewise, Congress can, if it sees fit, discriminate between various types of insurance companies so long as it maintains geographical uniformity.

In this case there is no discrimination whatever with respect to life insurance companies. The same tax is laid on all, in precisely the same manner and is uniform throughout the United States.

In the Court below, there were various cases, under the Fourteenth Amendment, cited which are not applicable to this case, as it is one which deals, not with the power of the States, but with the power of Congress.

In *La Belle Iron Works* v. *United States*, 256 U. S. 377, the Court referred to the argument based upon cases decided under the equal protection clause of the Fourteenth Amendment and said that they were clearly not in point. Said the Court (p. 392):

> "The Fifth Amendment has no equal protection clause; and the only rule of uniformity prescribed with respect to duties, imposts, and excises laid by Congress is the territorial uniformity required by Art. 1, § 8."

The Court added (p. 393):

> "Of course it will be understood that Congress has very ample authority to adjust its income taxes according to its discretion, within the bounds of geographical uniformity. Courts have no authority to pass upon the propriety of its measures; and we deal with the present criticism only for the purpose of refuting the contention, strongly urged, that the tax is so wholly arbitrary as to amount to confiscation."

Nor is there any discrimination against tax exempt securities. Interest derived from these securities is exempt in the case of every life insurance company subject to the tax.

It would be idle to maintain that Congress must adapt its legislation so as to give a preference to State securities. The whole doctrine of tax exempt obligations of a State or its political divisions is simply that Congress must not tax them. In the present case no insurance company that desires to invest in State or municipal securities is prevented from doing so. Any insurance company that invests in such securities holds the income therefrom free of the tax. What more can be asked of Congress?

There is not the slightest basis for the charge of unconstitutional discrimination.

FIFTH. Congress was entitled to provide a special excise tax for life insurance companies and to fix the measure of the tax as provided in Sections 244 and 245.

A tax of this kind is a tax with respect to the business done by a corporation. It is an excise tax. As such, Congress is competent to establish its measure.

When the Corporation Tax Act of August 5, 1909, c. 6, 11 (36 Stat. 112-117), was before the Supreme Court in *Flint* v. *Stone Tracy Company*, 220 U. S. 107, strenuous objection was made to the tax not only because of inequalities, which were disposed of by the Court in a manner already stated, but also because it was said to reach property not the subject of taxation. Insurance companies having invested in State and municipal bonds presented these objections. The Court found that in view of the nature of the tax the objection was untenable because in such case the measure of the tax might be the income from the property of the corporation, although a part of such income was derived from property in itself non-taxable. The Court said (p. 162):

> "It is further contended that some of the corporations, notably insurance companies, have large investments in municipal bonds and other non-taxable securities, and in real estate and personal property not used in the business, that therefore the selection of the measure of the income from all sources is void, because it reaches property which is not the subject of taxation—upon the authority of the *Pollock Case, supra.* But this argument confuses the measure of the tax upon the privilege, with direct taxation of the estate or thing taxed. In the *Pol-*

> *lock Case,* as we have seen, the tax was held unconstitutional, because it was in effect a direct tax on the property solely because of its ownership."

After referring to several cases cited by counsel, the Court continued (p. 163):

> "There is nothing in these cases contrary, as we shall have occasion to see, to the former rulings of this court which hold that where a tax is lawfully imposed upon the exercise of privileges within the taxing power of the State or Nation, the measure of such tax may be the income from the property of the corporation, although a part of such income is derived from property in itself non-taxable. The distinction lies between the attempt to tax the property as such and to measure a legitimate tax upon the privileges involved in the use of such property."

The Court then referred to the case of *Home Insurance Company* v. *New York,* 134 U. S. 594, where a tax was sustained upon the right or privilege of the Home Insurance Company to be a corporation, and to do business within the State in a corporate capacity, the tax being measured by the extent of the dividends of the corporation in the current year upon the capital stock. Although a very large amount, nearly two or three millions, of the capital stock was invested in bonds of the United States, expressly exempted from taxation by a statute of the United States, the tax was sustained as a mode of measurement of a privilege tax which it was within the lawful authority of the State to impose.

Reviewing other cases, the Supreme Court reasserted its conclusion (p. 165):

> "It is therefore well settled by the decisions of this court that when the sovereign authority has exercised the right to tax a legitimate subject of taxation as an exercise of a franchise or privilege, it is no objection that the measure of taxation is found in the income produced in part from property which of itself considered is non-taxable. Applying that doctrine to this case, the measure of taxation being the income of the corporation from all sources, as that is but the measure of a privilege tax within the lawful authority of Congress to impose, it is no valid objection that this measure includes, in part at least, property which as such could not be directly taxed."

The authority of this case was recognized in *Northwestern Mutual Life Ins. Co.* v. *Wisconsin*, 275 U. S. 136, decided at this term.

This disposes, we think, of the argument of the claimant as to the extent of the authority of Congress.

The Corporation Tax Act was succeeded by the Income Tax Act of 1913 which provided for the taxtion of income both of individuals and corporations. But the distinction between a tax on the income of property solely because of ownership, of the sort held invalid prior to the Sixteenth Amendment in the *Pollock Case* (157 U. S. 429; 158 U. S. 601), and as excise tax laid on the gains of an occupation or business (which was recognized to be valid in the *Pollock Case*) or an excise tax laid on the business of a corporation, still holds good, although these various sorts of taxes may be found in the same statute.

This clearly appears from the decision of the Supreme Court in *Stanton* v. *Baltic Mining Company*, 240 U. S. 103. This was one of the series of cases arising under the

income tax provisions of the Act of 1913, the leading one of which was the *Brushaber Case*, 240 U. S. 1. The *Baltic Mining* case presented a different phase in that it was a mining corporation and that it insisted that the provisions with respect to mining property rendered the tax invalid because an inadequate allowance by way of deduction had been made for the exhaustion of the ore body, and hence that the tax by reason of its effect, despite the Sixteenth Amendment, was a direct tax and could not be laid without apportionment. But the Court (p. 114) dismissed the contention by treating it is a wholly fallacious assumption because the tax was an excise on the results of the business. The Court cited as authority the case of *Stratton's Independence* v. *Howbert*, 231 U. S. 399, which had arisen under the Corporation Tax Act saying:

> "We say wholly fallacious assumption because independently of the effect of the operation of the Sixteenth Amendment it was settled in *Stratton's Independence* v. *Howbert*, 231 U. S. 399, that such a tax is not a tax upon property as such because of its ownership, but a true excise levied on the results of the business of carrying on mining operations (pp. 413 *et seq.*)."

If a tax on a mining corporation in a general income tax act can be treated as a special excise tax and governed by the rules which are applicable to such a tax, there is no reason why a special excise tax should not be laid with respect to the business of life insurance corporations.

We do not understand that there is anything in the decision in *Frick* v. *Pennsylvania*, 268 U. S. 473, or in the reasoning of the opinion which supports in the slightest degree the petitioner's contention. Of course, a State can-

not by any method tax property which is outside the limit of its jurisdictional authority. And Congress likewise must act within its constitutional sphere. Pennsylvania did tax the transfer of the property which had its situs in New York and the tax was invalid. Here, Congress has not taxed the securities or instrumentalities of the States.

In this case, as already stated, Congress has not sought to measure the tax with reference to a total income embracing interest from tax exempt securities. Congress has done the fair thing and permitted a deduction of the interest of tax exempt securities. It has taken account of the special exigencies of life insurance companies in relation to their legal reserves and has allowed a deduction for a certain percentage of the mean of reserve funds. It has simply provided that in calculating this amount, what has already been deducted, for interest on tax exempt securities, should be excluded from the amount deducted as interest on the reserve.

This is not a case where a statute is sought to be sustained by calling a tax something which it is not. The fact that the tax is embraced in a general income tax act, does not prevent the application of the differentiations which obviously apply to its various provisions. There are taxes laid under the general act which, but for the Sixteenth Amendment, would be invalid as direct taxes on property, by taxing the income from it, as held in the *Pollock* case. There are other taxes of gains from occupations which have always stood on a different footing. These are special excise taxes.

In this case the tax is only on a part of the income of the life insurance companies. It grants large deductions

as a matter of policy. It is distinct from every other tax in the revenue act. When petitioner's counsel says that it is an income tax, it does not seem to us that he says anything more than that it is a tax on income. But the nature of the tax on income remains to be considered, and its special features and the nature of the deductions allowed must be examined in order to determine constitutional invalidity. When so considered, we believe that it clearly appears that Congress in laying the tax has kept well within its constitutional power.

It is obvious that the tax is not the usual income tax on the whole gross income less deductions for expenses to reach the entire net income. The tax is on a selected portion of income. There is no account taken of premium receipts, but only of income from investments. The deduction of the 4 per cent. on reserve is thus not an ordinary deduction to reach net income in the usual sense, but a calculated deduction as a matter of policy in relation to a particular business. The tax as thus laid is plainly a special excise tax and the power of Congress in laying it is to be considered in the light of the nature and policy of the deduction permitted in calculating it.

A ruling that the tax in question was invalid would, it is believed, cause great inconvenience in overriding a method selected with care, and one that is satisfactory, we believe, to the great majority of life insurance companies. It would seem to be clear that such a ruling should not be made unless absolutely required by the limitations governing the constitutional authority of Congress. Instead of such a conclusion being a necessary one, it would be, we submit, opposed to the established principles of constitutional law.

Respectfully submitted,

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